OHIO CREDIT
UNION LEAGUE

April 6, 2009

Ms. Mary F. Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

RE: **Ohio Credit Union League Comments on ANPR for Part 704**

Dear Ms. Rupp:

On behalf of the Ohio Credit Union League, we are filing this letter with the National Credit Union Administration to address the future of the U.S. credit union Movement's corporate credit union system, in response to NCUA's Advance Notice of Proposed Rulemaking on corporate credit unions. The Ohio Credit Union League is a credit union trade association representing the interests of Ohio's 412 federal and state- chartered credit unions and their 2.6 million credit union members. This comment letter is offered under the auspices of the Ohio Credit Union League's Board of Directors and Government Affairs Committee.

The viewpoints, comments, and recommendations herein are made with full acknowledgement and respect for the important role the NCUA Board plays in the viability and safety and soundness of natural person credit unions and corporate credit unions across the country. Thank you for the opportunity to comment on these key issues which have much to do with the long-term health and success of all aspects of the credit union Movement.

A. <u>Overview of OCUL's Views</u>

1. To heighten the effectiveness of its actions, NCUA should proceed forward with corporate credit union system intervention and improvement with more effective communication and a more deliberate process

2. NCUA needs to ensure that all credit unions' interests are represented fully as strategies for corporate credit union system change are contemplated and implemented

3. NCUA should be more transparent with regard to its supervision practices, performance, and intervention in the corporate credit union system

4. NCUA should follow a credit union-driven blueprint for future essential roles and services to be provided to natural person credit unions as the dominant force in shaping improvements and changes

5. NCUA should embrace a set of guiding principles which focus change and improvement strategies in the underlying causes of the corporate credit union system's problems

6. NCUA, recognizing its contributions to the problems, risks, and costs now facing the corporate credit union system and natural person credit unions, needs to act more effectively and collaboratively to develop mitigation solutions

B. <u>Industry Communication & Deliberate Process</u>

The Ohio League is aware that NCUA has been under pressure to confront and resolve problems in the corporate credit union system. We respect NCUA's responsibility and determination in taking action that it deems necessary for the purposes of "stabilization," with regard to both corporate credit unions and natural person credit unions. Still, the Ohio League remains concerned that NCUA's latest interventions appear to be made in haste and with insufficient industry communication. Our concern is rooted in the impression that unneeded costs and disruptions are forced on the credit union system due to the haste and lack of communication that have accompanied NCUA's material intervention actions to date. Our concern is magnified by NCUA's lack of transparency involving information, motivations, and decisions related to these actions. We urge NCUA to proceed with a careful and deliberate rule-making process, accompanied by open industry communication and dialogue, so that the optimal corporate credit union system changes can be identified and implemented.

C. <u>Representation of All Credit Unions' Interests</u>

The Ohio League is aware that there are a number of organized input initiatives underway, the purpose of which are to influence NCUA's direction with regard to the corporate credit union system of the future. Three prominent industry examples include CUNA's Corporate Credit Union Task Force, the Corporate Credit Union Stabilization Partnership, and the Association of Corporate Credit Unions. One prominent non-industry example is the work done by Price Waterhouse Coopers directly for NCUA. We commend the expert analysis conducted and recommendations offered by structured groups such as these and we have confidence that such groups bring substance and value to NCUA's deliberations. Mostly, we are thankful for the work of these groups and others in bringing a diverse range of improvement options to NCUA's attention for further review. Some or all of these efforts have properly emphasized that a relatively small number of the industry's largest natural person credit unions enjoy a set of opportunities, with regard to the core services of the corporate credit union system, that are not afforded to a relatively large number of small-market or middle-market natural person credit unions. This is particularly important in a state such as Ohio, where statistics demonstrate a state-level credit union system abundant with small-market and middle-market needs. The average size of an Ohio credit union is approximately $45 million in assets and 6,400 members. Only 5 Ohio credit unions have scale beyond $500 million in assets. 89 percent of Ohio credit unions have assets of $100 million or less. 63 percent of Ohio credit unions have assets of $20 million or less. NCUA's context for change must include the premise that the core corporate credit union services are essential to the continued viability and success of small-market and middle-market credit unions. In this regard, the Ohio League's Small Credit Union Success Task Force asked that we emphasize in our comment letter three key themes: 1) in general, the corporate credit union system has been an invaluable success ingredient for small-market credit unions; 2) more specifically, Corporate One FCU has been among the most important viability partners for small-market credit unions in Ohio; and 3) looking forward, it is important that the corporate credit union system be preserved, improved, and extended as an essential resource for small-market credit union viability.

It is equally important that NCUA's change initiatives account for the needs and interests of large-market credit unions. The improved corporate credit union system of the future must command the leadership attention, service participation, and financial support of larger credit unions as a necessary ingredient of viability. A useful corporate credit union system of the future is one that attends to the diverse needs and wins the committed support of all types of natural person credit unions.

D. Regulatory Oversight, Supervision, & Transparency

The Ohio League believes that it is important to draw attention to NCUA's corporate credit union supervision practices, which are a contributing factor in the problems now evident in the corporate credit union system and are a contributing factor in the cost and disruption natural person credit unions are now compelled to deal with. The ANPR released by NCUA deals entirely within the construct of the role, structure, practices, and rules of the corporate credit union system. It seems not to invite questions and commentary with regard to the modern history of NCUA's corporate credit union system supervision structure, habits, and practices. We question the rationale for this omission. Any process involving corporate credit union system improvement should factor in all of the elemental causes of the need for change. We urge NCUA to include in this important process means for examining all major contributing factors, including NCUA's performance of its key supervision responsibility.

E. Essential Roles of the Corporate CU System

The Ohio League urges NCUA to center its consideration of corporate credit union system change in the essential functional purposes needed and wanted by its owners, the natural person credit unions. The credit unions, of course, are best able to speak to these needs and are best able to show conviction in action through the purchase and use of corporate credit union system services. In essence, form should follow function as change is implemented. With this in mind, the Ohio League urges NCUA to first identify the essential future roles needed by credit unions and only then consider structural questions of what system of corporate credit unions is best able to fulfill those needs in a competitive, safe and sound way. In our constant interaction with League member credit unions, we hear of categories of primary function or services as follows:

1. Payment processing (drafts, checks, ACH, wires, ATM, debit, etc.)

2. Settlement (settling the financial inflows and outflows resulting from payments processing and other natural person credit union transactions)

3. Short-term investments (overnight funds and other short-term investment transactions designed to optimize safety, liquidity, and yield of short-term surplus/funds)

4. Short-term liquidity (to facilitate settlement activity and to accommodate short-term/seasonal liquidity flows for natural person credit unions)

5. Long-term investments (natural person credit union portfolio investing over longer durations to provide investment and asset/liability management solutions beyond short-term needs)

6. Long-term liquidity (longer term lending and leverage solutions for natural person credit unions related to product, balance sheet, and asset/liability management purposes)

Our interaction with member credit unions suggests that categories 1 through 4 represent the "core service portfolio" applicable to the broadest set of natural person credit unions. The longer-term need considerations for investment and lending solutions in categories 5 and 6, respectively, have triggered more variability of opinion among our credit unions as to their essentiality and advisability in a future, improved corporate credit union system. This is understandable given that the relationships between risk, return, and capital in longer-term corporate credit union investment positions is one of several contributing factors to the problems evident in the corporate credit union system. To the extent that the corporate credit union system continues to play a role in these two longer-term financial-product areas, the risk management practices of the corporate system and the supervision practices of NCUA will need to be sufficient to measure up to the risks involved. To reiterate a central premise of the Ohio League's position on corporate credit union system improvement, form should follow function and credit union needs should dictate change. These needs may indeed involve longer-term solutions in both lending and investment areas. To the extent that natural person credit union needs drive elevated risk, corporate credit unions must elevate risk management competencies and NCUA must elevate risk supervision competencies.

F. <u>General Principles Regarding Change/Improvement</u>

The Ohio League appreciates NCUA's specific ANPR prompts with regard to a number of the technical aspects of the rules applicable to and the operational practices prevalent in the corporate credit union system. As noted earlier, we believe that definitive judgments in some or most of these areas is a difficult and risky proposition absent preceding work on the essential role or key service functions that would constitute the purpose of an improved corporate credit union system. Moreover, the Ohio League does not possess the proper expertise to comment in concrete, analytical terms on these more specific issues. However, the prompts do afford an opportunity to comment on general principles that would be useful in guiding work on the more technical matters. Such principles should be rooted in the underlying causes of the corporate credit union system problems that credit unions are burdened with today. We suggest the following principles as the context in which such issues should be addressed:

1. Going forward, all significant NCUA actions in regard to the corporate credit union system should be conducted in a manner reflecting deliberate process, effective communication, and full transparency.

2. NCUA supervision performance is a contributing factor. As such, it should be the equal citizen in study, change, and improvement to the work underway on the corporate credit union system itself.

3. Structural leverage is a contributing factor. The proper role and operational application of leverage to the corporate credit union business model must be studied carefully and redesigned with systemic risk in mind. It is likely that more limited uses

or forms of structural leverage will prevail in an improved corporate credit union system.

4. Capital framework is a contributing factor. There are disconnects at work in the corporate credit union system in the relationships between risk, return, and capital. It is likely that an improved corporate credit union system will involve higher general capital levels, more effectively risk-aligned capital measurement schemes, more demands on member natural person credit unions for capital formation, and more creativity in non-member and non-retained earnings forms of supplemental capital.

5. Settlement/payment risk is a vulnerability. Thousands of credit unions and millions of credit union members rely on the corporate credit union system for high-quality, cost-effective, technologically-proficient access to the settlement and payments systems that facilitate their participation in the economy. Therein lie financial, reputation, and public confidence risks for the entire credit union Movement should the settlement/payment systems be made vulnerable to any other risk elements in the corporate credit union system. These interdependencies, and systemic risks, have been made apparent to all in the recent problems within the corporate credit union system. Strategies for mitigating these risks should be fully explored as a primary theme for corporate credit union system improvement.

6. Concentration risk is a contributing factor. One could conclude that the corporate credit union system's rules, practices, and supervision were designed with concentration risk mitigation/avoidance strategies in mind. Yet we stand here today with the benefit of hindsight and witness the reality that regardless of the design framework, the corporate credit union system was indeed carrying significant concentration risk with regard to certain asset classes and with regard to dependence on ratings agency judgments. Clearly, the corporate credit union system improvements must adjust the design elements of how all manner of concentration risk is identified and managed. We further draw attention to the fact that the quality of concentration risk understanding and management varied considerably across corporate credit unions and within NCUA's supervision scheme.

7. Risk management infrastructure is a contributing factor. The system of "risk management," as an operational and supervision discipline across the corporate credit union network, appears to be proved inadequate. At the very least it is inconsistent, seemingly strong in some corners of the corporate credit union system and weak in others. The change and improvement process which NCUA has initiated via this ANPR is an opportunity to elevate the quality of risk management as an operational requirement and supervision priority.

8. Market and need driven structural change can facilitate future effectiveness. We are struck by the input we've received in which "consolidation" in and of itself, and "uniformity" in and of itself, are the answers to perceived corporate credit union system deficiencies. We do not see the wisdom in consolidation for the sake of consolidation, nor the wisdom of uniformity for the sake of uniformity. To express our view another way, we suspect that forcing consolidation and uniformity seems unlikely to be a better response to market realities than where the corporate credit union system stands today. We believe that the work presently underway with regard to the role/function issues noted herein and the principles enumerated above will drive a proper, need-and-market-driven level of consolidation and uniformity across a smaller and stronger group of corporate credit unions that will be the component parts of an improved and broadly supported corporate credit union system of the future. This kind of rational structural change can provide the

framework for safety and soundness and competitive value proposition that is required for natural person credit union success.

G. Costs and Implications of NCUA Corporate Stabilization Decisions

The Ohio League is concerned about the costs and risks (financial, operational, reputational, public confidence, etc.) to natural person credit unions resulting from NCUA's corporate stabilization actions initiated in January and continuing through the date of this writing. We do not have information that would support a confident impression that the initial Corporate Credit Union Stabilization Program or the more recent US Central and WesCorp conservatorships represent the least-cost, least-disruption, least-risk form of regulator intervention. If anything, our suspicion is that the cost, disruption, and risk to credit unions and their members are greater than necessary. In any case, we are now compelled to deal not only with the security-valuation driven problems in the corporate credit union system but also the related problems borne of NCUA's regulatory action. We question whether more effective supervision performance over the last 5 years might have precluded the need for the intense regulator intervention in the last 9 months. Still, NCUA's most recent announcement of a Corporate Credit Union Stabilization Fund appears to be a partial solution to the cost, disruption, and risk created in part through NCUA's contributions to corporate credit union system problems. For this reason, we support the stabilization fund and encourage more mitigation efforts along these lines as NCUA proceeds with changes to the corporate credit union system. Further, we wish to illuminate the stakes involved in new "stabilization" actions yet to be announced by the NCUA Board. In the last six months, we have received numerous inquiries concerning bank or thrift charter options available to natural person credit unions. The existence of the cooperative alternative hangs in the balance.

The Ohio Credit Union League appreciates the opportunity to participate in this Advance Notice of Proposed Rulemaking process regarding possible changes and improvements in the corporate credit union system. Thank you for considering the comments offered herein as you proceed with a formal rulemaking process. As needed, we would be happy to provide additional comments or clarifications.

Sincerely,

Paul L. Mercer
President

Cc: Board of Directors
Government Affairs Committee
Small Credit Union Success Task Force
Credit Union National Association